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Assessment of the Impact of USAID's Ten Years of Assistance in Micro-lending, Rural Credit, Mortgage, and Equity Investment



Romania's Unique Financial Mechanisms Assisted by USAID
August 2007

USAID's Role in the Successful Development of the Romanian Financial Sector

Romania's January 1, 2007 accession to the European Union (EU) was a major milestone made possible by political and economic changes over the past decade, which transformed the country into a vibrant market economy. During this time, the Romanians with United States assistance implemented programs to reform and strengthen the financial sector and mobilize capital for broad-based economic growth.

Preparing to close its Romania Mission in 2008, USAID conducted an assessment to evaluate the growth of the financial sector in Romania, identify USAID's role in this process, and document lessons that can provide a model for donor and government programming. This pamphlet summarizes the findings and conclusions of that report.

The assessment evaluated various financial mechanisms supported by USAID in Romania since 1996, including micro-lending, rural credit, mortgage finance, and equity investment. Impact was assessed at the **firm, financial sector, institution and enabling environment** levels. Findings include:

1. **Firms**, particularly microenterprises and small and medium-sized enterprises (SMEs), have been positively impacted by USAID and its partners.
 - The vast majority of SMEs experienced an increase in revenues, assets, and employment.
 - Equity investment recipients adopted new governance practices, attracting external capital and fueling growth.
 - More than \$70 million was leveraged for rural enterprises.
2. USAID involvement has had significant impact on the **financial sector** including the banking, investment, mortgage, and consumer finance markets.

- USAID, through the Romanian-American Enterprise Fund (RAEF), created the country's first mortgage finance company, a vehicle for sector reform and growth.
- RAEF supported the privatization and facilitated the foreign purchase of the agriculture bank.
- RAEF developed several leading consumer finance companies.

3. **Institutions** met varying financing needs and created sustainable legacies.
 - Equity investment funds were effective in growing and restructuring small and medium-sized private firms, achieving profitability, and attracting external capital.
 - All USAID-supported microfinance institutions (MFIs) are sustainable.
 - All institutions supported have left at least one institutional legacy, most of which demonstrate a strong private sector orientation.
4. Reforms in the **enabling environment** provide a foundation for future growth.
 - Laws enable the growth of MFIs.
 - Retail mortgage lending and secondary market legislation lay the foundations for mortgage market development.

The **success factors** of USAID's approach, which built sustainable legacy institutions and produced a broader ripple effect on the economy, include:

- Providing donor assistance across sectors
- Using diverse financial instruments
- Employing a commercial approach
- Developing businesses to promote broader policy changes
- Building on lessons learned from the region
- Coordinating with donors and government
- Promoting knowledge sharing to encourage business culture change

USAID's Impact on Romanian Private Firms



Then and Now

1996 – From a state-dominated system emerged entrepreneurs

In 1996, the private sector firms generated less than 50% of the country's GDP. Small businesses numbered approximately 100,000 in a country of 22 million people. Most large firms were still state controlled. In rural areas, farms and agribusinesses were still suffering from the shock of the reorganization of the sector after the 1989 revolution.

2007 – Rapid economic growth is fueled by the private sector

By 2007, the private sector generated nearly 70% of Romania's GDP. The total number of small businesses increased to over 500,000. More than 70% of all employed workers are in the private sector. High growth sectors are IT, service industries including the financial sector, retail, and the construction and real estate development markets.

USAID's Role

USAID supported the growth of private firms by funding:

- **The Romanian-American Enterprise Fund (RAEF)**—an investment fund designed to provide equity and loans to SMEs and newly privatized companies
- **The Small Enterprise Assistance Funds-Trans-Balkan Romania Fund (SEAF-TBRF)**—an investment fund to provide equity investment to SMEs
- **CHF-Express Finance**—a microfinance institution

- **The Rural Finance Leader Development (RFLD)** program—a joint USAID/USDA project facilitating access to finance for rural businesses

USAID's Impact

At the firm level, growth in levels of employees, assets and sales was identified. Trends confirmed industry level findings that credit is an engine of growth, particularly among small businesses.

Nearly 90% of SMEs reported increased revenues from the time when they received their first USAID-supported financing to today. More than 87% stated that their assets had increased, with the most increases in the service sector. The small business sectors with the highest levels of growth were the commerce and services sectors.

Among larger firms with direct investments, the “non-financial” asset of having a U.S.-funded investor on their board of directors, which took an active role in the strategic direction of the firms, the establishment of management structures and administrative procedures, and the search for other investors, resulted in real financial dividends. Most firms surveyed claimed that foreign direct investment and marketing opportunities, which resulted in firm growth, were the direct result of either SEAF or RAEF influence.

Smaller enterprises with less than 250 employees, after receiving financing, achieved the highest growth rates, particularly in terms of revenues and employment growth.

The Romanian Financial Sector

Then and Now

1996 – Transitioning to a freer market... on unstable ground

In 1996, state banks dominated the financial sector, with unpaid debts from government-owned enterprises, over-inflated infrastructure and limited commercial finance activity. The few private banks in the market were on shaky foundations and were poised for collapse. Consumer and investment finance was nearly unavailable and SMEs had few credit options.

2007 – A time of great expectations

In 2007, the financial sector is booming, dominated by large foreign-owned banks, which have brought expertise, technology and lower-cost funds that have served to help drive down interest rates as the sector becomes more competitive. The consumer finance market is expanding with new products and institutions serving a variety of the retail market needs, with notable development in mortgage lending. SMEs and individuals can access finance throughout the country from a bank or MFI and in some regions from a mortgage finance, leasing, or consumer finance company. Investment is increasingly available from private funds and the stock exchange.

USAID's Assistance

USAID successfully created the first mortgage finance company, Domenia Credit, with technical assistance, an initial investment from the Romanian-American Enterprise Fund (RAEF), and a USAID-backed Development Credit Authority guarantee of a loan from a large bank. USAID provided technical assistance to develop the necessary legal framework for the company's operation.

RAEF participated in the privatization of the major state-owned agricultural bank, and purchased and transformed another private bank. Other RAEF investments became market leaders in consumer finance and automobile leasing.

USAID funded several MFIs in the country: CHF-Express Finance directly, and others indirectly through RAEF.

USAID's Impact

The financial sector was impacted in particular by RAEF, which played key roles attracting foreign direct investment into the banks and other finance companies in which it had invested. This contributed to the sector's stabilization.

The RAEF investment in Domenia Credit blazed a trail for the creation of the retail mortgage market and the institutions and structures necessary to support it. Several financial institutions and investment funds remain as legacies.

MFIs supported by USAID are the three largest in the country, are sustainable and provide access to finance to hundreds of thousands of borrowers.



Institutions Supported and Legacies that Remain



Then and Now

1996 – USAID created new institutions for diverse support

In 1996, when USAID's first major initiative to support the private sector in Romania, RAEF, began its operations, there were few options for private businesses seeking investment or loan finance. USAID's approach to grow the sector was to establish mechanisms to provide financing and technical support.

2007 – Remarkably successful institutions plan their legacies

RAEF and SEAF-TBRF fulfilled their development mandates and achieved commercial success. CHF-Express Finance and two other MFIs with RAEF funding are all providing SME loans in a financially sustainable manner, with strong management structures and systems. Many of the products and services offered by these programs and their legacy institutions, particularly in the small business lending and mortgage markets, have served as drivers for industry standards, creating ripple effects in other institutions in the sector.

USAID's Assistance

Romanian-American Enterprise Fund was established in 1994 by the U.S. Congress with \$61 million to assist Romania in its transition to a free market economy by providing finance for SMEs, greenfield and newly privatized companies. Governed by an independent board of directors, RAEF pursues both development and commercial objectives. The fund's micro and small loan program provided small business loans through banks and MFIs including CAPA-World Vision (CAPA), CHF, Opportunity Microcredit Romania (OMRO), Banca Transilvania and Banca Romaneasca.

CHF-Express Finance in 1996 and 1999 received USD 1.15 million from USAID to provide microfinance services. In 2003 USAID provided USD 0.5 million for lending to flood victims and USD 1.2 million to cover investments and expenses for CHF to establish a sustainable microfinance institution, later renamed Express Finance.

Small Enterprise Assistance Funds- Trans-Balkan Romania Fund (SEAF-TBRF) was established in December 2000 with \$8.5 million in seed capital to provide equity and loans to SMEs with growth potential. SEAF, a not-for-profit corporation with USAID and international finance institution funding, establishes and oversees the management of commercially sustainable, for-profit, private equity funds in emerging markets.

Rural Finance and Leader Development (RFLD) program was funded by USAID and implemented by the USDA from 2003 to 2007 with \$970,000 to build business consulting capacity and facilitate access to finance in rural districts.

USAID's Impact

Each institution and program above has created or supported at least one financially sustainable institution that should continue to provide finance or business support to private enterprises and individuals beyond USAID's presence in Romania.

- **RAEF:** Balkan Accession Fund, Enterprise Advisors, the Energy Efficiency Fund, Banca Romaneasca, Domenia Credit, Ralfi, Motoractive, Raiffeisen Bank, the RAEF foundation, CAPA, and OMRO
- **CHF:** the non-bank financial institution Express Finance
- **SEAF-TBRF** and **RFLD** program: Center for Entrepreneurship and Executive Development (CEED)

The Enabling Environment Reforms and Support Systems Building Strong Private Sector Foundations



such as tax reforms and privatizations. By 2001, the country began steady economic growth with declining inflation and interest rates. Bureaucracy for new and growing private businesses has been slashed, banking regulations improved, and reforms to decentralize government processes are being pursued.

USAID's Role

USAID institutions and investments served as catalysts for broader-based legislative and policy reforms. In 2002, RAEF privatized Banca Agricola and established Domenia Credit, the first mortgage finance company in the country. USAID's Enterprise Development and Strengthening program and Capital Markets Reform Project promoted legislative and policy reform for microfinance, consumer finance, and exchange activities. The RFLD program built the capacity of business and government leaders to work together to ease a number of burdensome business regulations. USAID also provided support to the government to develop the RASDAQ Exchange now part of Bucharest Stock Exchange.

Then and Now

1996 – Beginning the pursuit of political stability, economic reform and EU accession

The middle to late 1990s witnessed a period of economic turmoil, with inflation soaring over 200% and high profile bank closures. In 1996, banks were still viewed with distrust by average citizens and the business environment was characterized by high levels of bureaucracy.

2007 – Entering the EU as a country with great promise

After 2000, a series of macroeconomic developments paved the way for private sector growth,

USAID's Impact

The privatization of Banca Agricola and establishment of Domenia Credit encouraged other privatizations and mortgage companies. With the support of USAID, the 2005 MFI Law, the 2006 Non-bank Financial Institution Law, and laws enabling the secondary mortgage market were passed. These enabled operations and clarified the supervision of MFIs, mortgage finance companies and other non-bank financial institutions. At the national level, business regulations including registration requirements and waiting periods for permits were reformed to be friendlier to small businesses, particularly in the agriculture and tourism industries.

Remaining Gaps and Challenges



There are a number of remaining gaps and challenges to the development of the overall private sector and to the financial sector in particular.

- Private enterprises and consumers still have **unmet demand for credit**.
- **The stock, bond and securities markets** are in early stages of development, and the secondary mortgage finance market is inactive.
- **Human resources**, finding and keeping well-trained individuals, pose a challenge for the financial sector and enterprises that are growing rapidly.
- Foreign-owned banks with low costs of capital, some of which are moving down-market to lend to SMEs, pose **competition to some MFIs**.
- MFIs need additional equity or loan **funding to fuel microfinance lending** growth.
- SMEs continue to cite **government bureaucracy** as an impediment to growth.
- **EU accession** will pose particular challenges to the SME sector in terms of competitiveness.
- In rural areas small land parcels and a lack of developed wholesale markets inhibit **agricultural market development**.



Success Factors and Lessons Learned

The Romanian Private Sector is Stronger with USAID Support for Financing

As Romania graduates from USAID assistance, clear evidence of the success of USAID's interventions in the financial sector is that, today, market forces fuel financial sector and firm growth; a number of USAID supported institutions will live on in the new EU reality; and the business environment is characterized by growing investor confidence.



USAID's approach to developing the private sector succeeded in building sustainable financial institutions, which in turn produced a broader effect on the economy.

Success factors of USAID's strategy include:

- Investing donor funds and technical assistance across sectors
- Using diverse financial instruments
- Employing a commercial approach
- Developing businesses to promote broader policy changes
- Building on lessons learned from the region
- Coordinating with donors and government
- Promoting knowledge sharing among local and international professionals to encourage business culture change

Lessons learned from USAID-funded activities include:

- Flexibility is essential to meeting financing needs as an economy changes.
- Promoting a commercial approach, such that local partners and institutions profit, leads to greater sustainability of initiatives.
- Equity investments in an emerging economy benefit from a hands-on approach.
- Technical assistance for bank training can effectively promote new services and products.
- Approach barriers to expansion head-on, cooperating with government and other donors.
- Legal structures and the ability to enforce contracts are important to the development of an equity market.
- Finance is an engine for growth for SMEs and financial institutions.
- An institution can serve as an instrument to greater industry reforms.
- Government engagement is important and can have lasting effects.